

HIGHLINE SCHOOL DISTRICT No. 401
King County, Washington
September 1, 1991 Through August 31, 1992

Schedule Of Findings

1. Highline School District Officials Need To Improve Federal Program Payroll Controls

Our review of payroll charges coded to federal programs indicated that payroll costs amounting to \$3,217 were distributed without adequate documentation. Our testing noted that individuals received federal funds for extra service and optional work day pay based on handwritten time sheet comments. We questioned the extra service and optional work day pay of individuals who did not have an extra service contract or an approved optional day contract to support the time charged.

In addition, our testing of time sheets disclosed the following additional problems:

- a. Time sheets were prepared in pencil.
- b. Time charged to federal programs was not reported on a time sheet nor was the time sheet signed by employee.
- c. July and August time sheets were not properly certified by a district supervisor.

The Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State and Local Governments*, Attachment B, Section B.10.b state:

. . . Payrolls must be supported by time and attendance or equivalent records for individual employees. Salaries and wages of employees chargeable to more than one grant program or other cost objective will be supported by appropriate time distribution records. The method used should produce an equitable distribution of time and effort.

Federal programs have been inappropriately charged when administrators do not properly complete and submit employee contracts and employees do not complete and sign their own time sheets. In addition, pencil notations can be readily changed without the knowledge or approval of the employee or the supervisor reviewing time charges.

We recommend payroll charges to federal programs be for allowable costs supported by employee time sheets properly completed in ink, signed by the employee, and certified by the appropriate supervisor. We also recommend that prior to making time charges, employment contracts for employees charging time to federal programs be properly completed and submitted to the district's personnel and payroll departments.

2. Highline School District Officials Need To Strengthen Internal Controls Over Personnel And Payroll Systems

Our review of the district's personnel and payroll system disclosed the following weaknesses:

- a. A segregation of duties is lacking between the personnel and payroll departments:
 - (1) Both the personnel and payroll departments have the capability to change employee contract salaries and hourly pay rates through their access to the computer system.
 - (2) Absentee leave reports are not always properly completed by employees and supervisors and approved by the personnel department in accordance with district policy. Our testing of 136 transactions indicated that the payroll department processed 34 incomplete and unauthorized employee leave reports.
- b. Time sheets are not properly completed and certified. Our testing noted that an office staff person at each payroll location completed time sheets for all employees at that location. Also, several of the time sheets reviewed were completed in pencil and the majority of the July and August time sheets were not certified.
- c. The accounting and the payroll departments appear not to enforce district contract provisions by allowing employees to accrue and carry forward vacation leave in excess of contractual provisions.

The OMB Circular A-87, *Cost Principles for State and Local Governments*, Attachment B, Section B.10.b states in part:

. . . Payrolls must be supported by time and attendance or equivalent records for individual employees. Salaries and wages of employees chargeable to more than one grant program or other cost objective will be supported by appropriate time distribution records. The method used should produce an equitable distribution of time and effort.

The district's Personnel (employment) Contracts - Administrative states:

Up to thirty (30) days (or the equivalent thereof) of unused vacation may be carried over to an ensuing year under this contract.

These control weaknesses indicate an increased risk that employees could be overpaid and accumulate compensated leave balances in excess of contractual limits. The recognition of the excess leave balances as a liability could cause the financial statements to be overstated.

The problems appear to result from inconsistent application and enforcement of district policies and procedures in the facilitation of payroll processing.

We recommend:

- a. The payroll department not have computer system access capabilities to change employee contract salaries and hourly pay rates.
- b. The payroll department comply with district policy and not process unauthorized

leave reports.

c. Time sheets be completed in ink and be certified.

We further recommend the district comply with personnel contract provisions and properly account for and report employee vacation leave.

3. District Officials Should Comply With Handicapped Grant Awards

Our review disclosed that district federal Handicapped grant fund expenditures were not always disbursed in accordance with approved project budgets. Federal Handicapped grant funds were awarded to the district under nine different projects and two CFDA numbers for fiscal year 1992. For each project, an application, including a detailed budget for expenditures, was required to be submitted to the grantor agency.

Additionally, the grant award required a budget revision when budgeted line items change by more than 20 percent. Also, final expenditures for a grant project could not exceed the budgeted total, and, actual line item activity could not be more than 20 percent in excess of the budgeted amount. No actual expenditure could be made in activities or objectives which were not on the approved budget.

Each federal Handicapped grant award states:

This grant award is made for activities described in the Proposal, in the amounts shown above. The funding for each component is specified in the attached budgets.

The project must be conducted in accordance with the activities described in the components and with the applicable regulations for each program.

Our testing of the grant project budgets disclosed:

- a. Three instances of expenditures exceeding the budgeted amount.
- b. Six instances of expenditures charged to line items that were not budgeted.
- c. Two instances of actual expenditures exceeding the budget by more than 20 percent.

It appears the district's accounting staff is not afforded the opportunity to review grant budgets prior to their submission to the grantor. This results in incomplete grant budget information being available to accounting to enable them to accurately account for grant charges.

Failure to adhere to grant project budgets is a violation of the terms of the grant awards. Additionally, failure to monitor actual disbursements may result in charging ineligible expenditures to grant projects. Finally, federal funds could be denied in future years.

We recommend district officials comply with the terms of federal Handicapped grant awards by:

- a. Amending project budgets when line item activities change.
- b. Reviewing actual project expenditures to assure these activities have been budgeted.
- c. Reviewing actual project expenditures for compliance with budgets and approving grant project entries which reduce previously recorded expenditures.

4. Highline School District Officials Need To Strengthen Internal Controls Over Accounts Payable System

Our review of the district's accounts payable system disclosed the following weaknesses:

- a. The accounting department has computer system access capabilities enabling it to change vender information and purchase order amounts.
- b. Personal service contract billings are not adequately supported and reviewed before payments are made. We noted payments of \$1,756 on personal service contracts where the provision of the contract services were not adequately documented.

The "Common Rule" for *Uniform Administrative Requirements for Grants and Cooperative Agreements With State and Local Governments*, Subpart C, .20(b) states:

- (2) Grantees and subgrantees must maintain records which adequately identify the source and application of funds . . .
- (3) Effective control and accountability must be maintained for all grant and subgrant cash . . .

The lack of adequate internal controls involving accounts payable increases the risk that funds could be misused and accounting records could be materially misstated. In addition, federal programs could be charged inappropriately when vouchers are not properly completed and approved before payments are made.

The problems noted were the result of control weaknesses in the district's accounts payable procedures and had the appearance of inadequate monitoring and review by the district management.

We recommend district officials strengthen controls over accounts payable by requiring that all approved district vouchers be for allowable costs and be properly supported and approved before the distribution of funds.

5. District Officials Should Comply With Associated Student Body (ASB) Regulations Regarding Disbursements For Activities

Our review of the district's ASB activities for the fiscal year 1992 indicated that several schools exceeded their budgeted amounts and ended the fiscal year with negative ASB fund balances. One school apparently did not submit an ASB budget for fiscal year 1992, but continued to collect and disburse ASB funds. Several schools reported ASB expenditures in accounts and activity groups where no activity had been budgeted.

Using a report provided by Washington School Information Processing Center (WSIPC), it was determined that ASB organizations at two schools ended the fiscal year with negative fund balances. Additionally, 12 activity groups at various schools ended the fiscal year with negative balances ranging from \$.89 to \$10,000.00.

Washington Administrative Code (WAC) 392-138-050 reads in part:

Associated student body moneys shall be disbursed subject to the following conditions:

(1) No disbursements shall be made except as provided for in the approved budget . . .

(5) When the fund balance account of an associated student body organization does not contain a sufficient balance to meet a proposed disbursement, such disbursement shall be limited to the account balance: *Provided*, That a transfer of fund balance between associated student body organizations may be made

Part 2A, *Accounting Organization and Methods of the Washington State Schools Accounting Manual* in Section 3.a. Methods-Budgeting states in part:

Under the supervision of the primary advisor a budget will be prepared annually . . . for each associated student body. It is important to note that no activity has a negative ending balance.

This concept is the same as that expressed in RCW 28A.58.120 and WAC 392-138-050(4) but applied at the level of the student activity group. It means no student activity group can disburse moneys unless moneys are available in the student activity group's account. If there is not enough money available, moneys will need to be transferred before the disbursement can be made.

ASB expenditures in excess of approved budget amounts violate applicable state regulations. Additionally, such expenditures subsidize some ASB activities at the expense of other activities, without student consent or proper approval. District management was apparently unaware of these ASB requirements.

We recommend district officials implement policies and procedures to enforce and comply with ASB requirements which prohibit disbursements in excess of an activity's fund balance.

6. District Officials Should Follow Accounting Policies And Procedures And Value The Equipment, Materials, And Supplies Inventory Correctly

The district's equipment, materials, and supplies inventory is valued at replacement cost rather than historical cost. There are two fields in the software program used by the district in which unit cost may be entered. One is for replacement cost and the other is for purchase or historical cost. Currently, the inventory clerk is inputting the same amount in each field. All student desks are assigned one tag number. When a purchase is input for student desks the unit cost of the new desks is input and the entire inventory of student desks is re-valued at the new cost. This means that the equipment inventory is all valued at the most recent cost, or replacement cost. The same re-valuation occurs when inventory is transferred from one school to another. The unit cost of the new desks becomes the unit cost of all desks at that location.

The Accounting Manual For Public Schools In The State Of Washington in Chapter - Principles of Accounting, states:

Principle 6 - Valuation of Fixed Assets

Fixed assets should be accounted for at cost or, if cost is not practically determinable, at estimated cost.

Chapter III - Accounting Guidelines, Guideline No. 6 - Fixed Assets, states:

Asset Cost

The original cost of an asset is referred to as the "historical cost."

This condition is due to inadequacies in the Washington School Information Processing Center (WSIPC) Fixed Assets software program and a lack of an internal district fixed asset system to address these inadequacies. The WSIPC Fixed Asset System is unable to layer the inventory and is not capable of tracking purchases at other than the new cost.

The district is valuing the equipment, materials, and supplies inventory at replacement cost rather than historical cost, which is not in conformity with generally accepted accounting principles. In addition, the balance on the financial statements is overstated, though not in a material amount.

We recommend district officials follow generally accepted accounting principals and their own policies and procedures and value their inventory at historical cost. We further recommend district officials address the inadequacies in the WSIPC fixed assets software program by establishing their own system to track purchases by layer.

7. District Officials Should Provide For Segregation Of Duties Over The Control Of The Equipment, Materials, And Supplies Inventory

There is no segregation of duties for input and reconciliation of the equipment, materials, and supplies inventory balance. The inventory clerk runs edit/update reports after each input session to the inventory system. A fixed asset report is run once a month and the clerk reconciles the edit/updates to the fixed asset report. No review is performed by accounting. In addition, the inventory clerk, due to the lack of timely documentation, is inputting from purchase orders rather than paid invoices or vouchers.

We attempted to trace 13 equipment purchase vouchers to the fixed asset system. Three of the purchases were not in the system. Of those we were able to trace, four out of six were incorrectly input, as the sales tax and shipping charges were not included.

There appears to be limited emphasis on the accurate valuation of the equipment, materials, and supplies inventory.

The fixed asset report is not complete and the items listed are not valued correctly. The equipment inventory balance is frequently understated for the related sales tax and shipping.

We recommend district officials provide for segregation of duties over the control of inventory to ensure that inventory is complete and valued correctly.

8. District Officials Need To Improve Internal Controls Over Valuation Of The Vehicle Equipment Inventory

Our review of the district's detailed school bus inventory records found several discrepancies between those records and the valuation of that inventory on the district's financial statements for the fiscal year ending August 31, 1992. The differences noted were:

- a. Seven buses were recorded on the financial statements at a cost which included Washington state sales tax, but the tax amount was not included on the detailed inventory records maintained at the district's motor transport office.
- b. Two buses were recorded on the financial statements at \$65,560 each (including sales tax), but the detailed schedule provided by the transport office valued each of these buses at \$0.
- c. Three buses were reported at one cost amount for financial statement purposes, and another amount on the detailed valuation schedule, but detailed records could not support any cost amount.
- d. The financial statement and valuation schedule amounts agreed for three other buses, but the detailed records either did not support a value or supported a higher value.
- e. Reported cost amounts could not be supported for two buses deleted from the bus inventory in fiscal year 1992.

The detailed records reviewed at the motor transport office were incomplete. The valuation schedule prepared from those records was adjusted, but the adjustments were not communicated to the motor vehicle office.

A system for correctly recording and valuing equipment inventory items is a critical part of management's responsibility for maintaining effective internal controls and protect district assets. Failure to maintain such systems could result in inaccurate reporting of the district's assets and could affect decisions regarding the disposition of those assets.

We recommend district officials improve internal controls over valuation of the vehicle inventory. We further recommend the detailed bus inventory records at the district's motor transport office include documented support for the purchase cost of each bus, and that the bus valuation schedule be prepared to support fiscal year financial statements to reconcile with the detailed records.

9. District Officials Should Emphasize And Monitor Internal Controls Over Associated Student Body (ASB) Disbursements

Our review of the district's disbursements from the Associated Student Body (ASB) funds determined that existing internal controls are not being consistently or correctly applied. This failure to control the flow of expenditures means that recorded transactions may not be relied upon for meeting their intended objectives or specified purposes.

Disbursements made from the ASB fund may be direct payments to vendors, reimbursements to the related school's checking account for ASB expenditures, reimbursements to the district Revolving Fund for petty cash-imprest expenditures, or reimbursements of mileage related to ASB field trips. We reviewed a selection of transactions from all four categories. Although forms and procedures exist to control and monitor these transactions, we found that these were not consistently applied.

Thirty-two transactions were reviewed which represented ASB reimbursement to the district's General Fund. A total of 11 control attributes were reviewed for each transaction. At least one exception was identified for each transaction resulting in an error rate of 100 percent. Twenty-three transactions had multiple exceptions resulting in an error rate of 72 percent. Further testing was suspended.

We reviewed 45 of the school's checking account reimbursements. These transactions were subject to specific exclusions and limitations as established by a district administration's memorandum. We found 22 exceptions to those restrictions resulting in an error rate of 49 percent. Further testing was suspended.

Twelve transactions were reviewed involving reimbursement of the district's Revolving Fund. A total of 11 control attributes was reviewed for these disbursements. At least one exception was identified for nine of these transactions resulting in an error rate of 75 percent. Eight of these items had multiple exceptions. Further testing was suspended.

We reviewed a selection of 38 transactions for direct payments from ASB to vendors. A total of 11 control attributes was reviewed for each transaction. Thirty-two of these transactions had at least one exception resulting in an error rate of 84 percent. Sixteen of these items had multiple exceptions. Further testing was suspended.

The widespread distribution of control exceptions and the apparent pattern of the exceptions appears to indicate a shortage of well-trained staff, or an inadequate management review and monitoring of the internal controls over ASB fund disbursements.

Failure to review expenditure transactions for adequate documentation and pre-approval does not fulfill management's responsibility to protect district assets and detect fraud. Disbursements may be made which are improper or illegal.

We recommend district officials emphasize, monitor, and consistently apply the existing internal controls to all ASB transactions.

10. District Officials Should Monitor And Emphasize The Internal Controls For The Journal Vouchers Process

Our review of the elements of the district's journal voucher process disclosed serious internal control weaknesses. We reviewed journal vouchers relating to accrual of federal grant revenues, fiscal year-end construction work-in-progress, maturing of tax anticipation notes, and "corrections-clean up."

The following weaknesses were noted:

- a. Supporting documentation was not attached or obtainable without substantial effort.
- b. Supervisory approval was not evident.
- c. A control log of consecutively numbered journal vouchers was not maintained.
- d. A clear and distinct separation of duties was not maintained between persons preparing journal vouchers and persons with approval responsibility.

The variety of control exceptions and the pattern of errors appears to represent a shortage of well-trained staff, or inadequate management oversight and monitoring of the internal controls relating to the journal voucher process.

Failure to apply internal controls to the journal voucher process could permit incorrect, improper, or mistimed entries to the district's accounting records and financial statements. Accruals may not be made, or may not reflect the correct allocation of resources and expenditures between fiscal periods. Entries which are not adequately supported and independently reviewed may not be appropriate.

We recommend district officials monitor and emphasize the internal controls for the journal voucher process by requiring:

- a. The district's Director of Budget and Accounting to assign a number to each journal voucher prepared during the fiscal year, and maintain a log of the numbers assigned.
- b. The person preparing each journal voucher sign and clearly indicate the date prepared.
- c. Approval of journal vouchers by a person other than the preparer.
- d. The person approving a journal voucher sign and clearly indicate the date approved.
- e. The person responsible for data entry of the journal vouchers sign and clearly indicate the date entered.
- f. Adequate supporting documentation be attached to each journal voucher.

11. District Officials Should Emphasize The Internal Controls For Cancellation Of Vouchers And Warrants

Our review of progress payments to construction contractors found instances where vouchers were cancelled without adequate documentation. We expanded our testing to include an additional seven cancelled payments to determine the extent of the internal control weaknesses. Federal funds were not involved.

Each voucher/warrant exhibited at least one testing attribute exception. These included:

- a. No evidence of approval of cancellation.
- b. No reason given for cancellation.
- c. Inadequate supporting documentation and no evidence of cancellation on the face of the warrant.
- d. Two warrants were cancelled on district records, but were redeemed according to King County records.

These internal control deficiencies are related to the weaknesses already noted - inconsistent application and enforcement of district policies and procedures, shortage of well trained staff, system deficiencies, and weak review and monitoring by management.

Failure to control the process of cancelling a voucher and its associated warrant permits errors to be included in district records, costs to be misstated, and provides an environment in which fraudulent transactions could be completed and not be detected in a timely manner.

We recommend district officials emphasize controls over vouchers and warrant cancellation by:

- a. Requiring approval of the cancellation to be made on the face of the voucher.
- b. Providing adequate documentation of the cancellation process, including related voucher number, date of cancellation, reason, name of person requesting the cancellation, and King County warrant number.
- c. Stamping "CANCELLED" on face of returned warrant.
- d. Reconciling King County warrant redemptions with district records.

12. District Officials Should Improve Internal Controls Over Progress Payments To Construction Contractors

Our review of progress payments made to construction contractors noted serious internal control weaknesses. Voucher payments made by the district lacked proper certification, supporting documents were missing, account codes used for disbursement did not agree to the district's purchase order, and the amount disbursed was not always supported by the attached documentation. In addition, one district voucher selected for testing could not be located.

The district reported an increase of \$15,661,741 in construction work in progress in fiscal year 1992 and transferred \$5,423,203 in completed projects to fixed assets. We included the projects with the largest cost additions, and all completed projects within our review. Federal funds were not involved.

The results of our review of seven construction projects in progress during fiscal year 1992 are:

- a. Land purchased in the amount of \$452,566.48, for expansion and modernization of an existing elementary school, evidenced no school board review or approval. The internal control weaknesses associated with this purchase are described in our Management Letter which is referred to in the audit report.
- b. Payments amounting to \$394,934.31 were made in fiscal year 1992 for architectural services related to the land purchase. We reviewed nine of the ten vouchers paid. One voucher could not be located for review. All nine vouchers had at least one audit testing attribute exception and six had multiple audit exceptions.
- c. The majority of the completed project transfers are for modernization work at three elementary sites. All vouchers had at least one testing attribute audit exception.
- d. Another project added \$5,337,351 in progress payments during fiscal year 1992 for which the contractor was overpaid \$3,632.63. The amount retained from contractor claim vouchers was excessive. A legal settlement and related payment were not adequately documented. A cancelled voucher was not adequately supported.
- e. Additionally, we noted internal control exceptions for the completion of a remodeling project at one district high school. These included alteration of documentary support, lack of details to support the extension of price and quantities, and the use of the project number for a separate activity which was bid and undertaken months after this project closed.

Given the frequency and distribution of errors and the consistency of results, further testing was suspended.

Construction projects are complex efforts, and cost monitoring is a critical management function. Failure to control the tracking and recording of project costs represents a significant internal control weakness, and could have a major impact upon the district's financial statements and civil liabilities.

The cause of the problems noted result from control weaknesses in the district's accounts payable procedures and apparent inadequate monitoring and review by district

management.

We recommend district officials improve internal controls over progress payments to construction contractors by:

- a. Assuring all construction vouchers paid are reviewed and properly certified.
- b. Attaching adequate supporting documentation.
- c. Assuring that disbursements are coded to correct accounts.
- d. Verifying the accuracy of all amounts disbursed and retained.